UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

UNITED STATES OF AMERICA	***)***	
	)	
v.	***)***	***Criminal No. 97-55-P-H***
	)	
CATHERINE DUFFY PETIT, et al.,	***)***	
	)	
Defendants	***)***	

AMENDED RECOMMENDED DECISION ON MOTIONS TO DISMISS

Now pending before the court is a series of motions, filed and/or joined in by various combinations of the five defendants, for dismissal of the government's 344-count indictment (Docket Nos. 34, 87, 88, 89, 90, 100, 103, 104, 105, 110, 112, 114, 124 and 128).[1] The motions to dismiss counts 2-5 and 7-15 (Docket Nos. 87, 103, 110, 112 and 114) seek, in the alternative, a bill of particulars. Also pending is a separate motion by defendant Steven A. Hall seeking only a bill of particulars (Docket No. 101). For the reasons that follow, I recommend the dismissal of Counts 3, 4 and 17, as well as the dismissal of Count 10 as against Richard only, and further recommend that the pending motions otherwise be denied.

I. Bankruptcy fraud

The defendants move to dismiss Counts 2 through 5 and 7 through 15, all of which accuse Petit and various combinations of other defendants of bankruptcy fraud in violation of 18 U.S.C.

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[1] Three of the pending motions also seek dismissal of Count I, which alleges conspiracy. I have previously considered the motions to the extent they involve this count and have recommended their denial with regard to the conspiracy claim. *See* Recommended Decision on Motions to Dismiss Count I (Docket No. 149).

§ 152.[2] According to the government, Petit's creditors filed an involuntary petition under Chapter 7 of the Bankruptcy Code naming her as the debtor on June 4, 1993, which was converted to a Chapter 11 petition on March 23, 1994 and converted again to a Chapter 7 proceeding on October 27, 1995. *See* Government's Memorandum of Law in Opposition to Defendants' Pretrial Motions (Docket No. 130) at 84-85 n.39.

Count 2 alleges a violation of subsection (1) of section 152. Under this provision, one who "knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor" is guilty of bankruptcy fraud. According to the indictment, the asset so concealed consisted of "funds raised from the sale of assignments of proceeds from PETIT's Key Bank litigation." Indictment at ¶ 17. The alleged conduct took place from on or about June 4, 1993 (the date of the bankruptcy petition) up to and including October 8, 1997. *Id.*

In seeking dismissal of Count 2, the defendants concede that the concealment of actual proceeds from the Key Bank litigation would amount to bankruptcy fraud, but they take the position that Petit's non-entitlement to those proceeds renders it impossible for her to have violated section 152 by purporting to assign the proceeds. According to the defendants, under the facts alleged in the indictment Petit is not guilty of violating section 152(2) for the same reason that one who purports to sell the Brooklyn Bridge has not, in fact, stolen anything from the government entity that is the true owner of the fabled East River crossing.

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[2] Petit has so moved as to the bankruptcy fraud counts (Docket No. 87), and the other defendants have joined in the motion (Docket Nos. 103, 110, 112 and 114).

Under the Bankruptcy Code, the bankruptcy estate of a debtor is not strictly limited to the property she owns or possesses as of the date of the petition in bankruptcy. Rather, the property of the estate also includes, *inter alia*, "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the [bankruptcy] case." 11 U.S.C. § 541(a)(6). The government's theory is that, because any proceeds of the Key Bank litigation were part of the bankruptcy estate, purporting to sell interests in those proceeds is bankruptcy fraud because the funds so amassed were properly part of the bankruptcy estate.

The purpose of section 152 is to criminalize "efforts to preempt a neutral and informed assessment by the trustee as to the status and value of the debtor's legal, equitable, and possessory interests in property at the commencement of the case." *United States v. Grant*, 971 F.2d 799, 805 (1st Cir. 1992) (citation and emphasis omitted). A debtor commits bankruptcy fraud by knowingly preventing the bankruptcy trustee "from exercising an informed judgment" as to whether the sums at issue should have been appropriated for the benefit of the creditors. *Id*. (suggesting that debtor can commit bankruptcy fraud by failing to disclose assets "whose immediate status in bankruptcy is uncertain") (citations omitted). Proceeds of bankruptcy estate assets are themselves part of the estate and may not be concealed from the trustee, and even assets that are "derivative" of proceeds must also be treated in such a manner. S*ee United States v. Ladum*, 1998 WL 178557 at *10 (9th Cir. Apr. 17, 1998). The assets obtained by Petit through selling interests in the Key Bank litigation are manifestly derivative of that cause of action, which is itself unassailably property of the estate. It is irrelevant that Petit's implicit representation to investors of unencumbered title to such an asset was itself presumptively fraudulent. If the owner of the Brooklyn Bridge becomes a debtor in

bankruptcy, it is still bankruptcy fraud to sell the bridge thereafter without disclosing the transaction to the bankruptcy court — because the required disclosure assures that the trustee will take whatever steps are appropriate to protect the creditors. Count 2 is not subject to dismissal.

Count 3 alleges that on or about February 25, 1994 Petit and Richard violated subection 2 of section 152 by failing to identify on bankruptcy schedules the investors who had been issued assignments of proceeds from the Key Bank litigation. The only plausible reading of the indictment is that Count 4 makes the identical accusation, but only as to Petit. Subsection 2 provides that a person is guilty of bankruptcy fraud when he or she "knowingly and fraudulently makes a false oath or account in or in relation to any case" under the Bankruptcy Code. 18 U.S.C. § 152(2). The filing of schedules by a debtor with the bankruptcy court does not involve the making of an oath or the giving of an account within the meaning of this subsection. *See* Collier Bankruptcy Manual (1997 ed.) ¶ 7.02[1][a][ii] at 7-6 to 7-7 (noting that "account" in this context refers to a "statement of a particular state of financial affairs, such as a false periodic operating report"); *see also United States v. Montilla Ambrosiani*, 610 F.2d 65, 67-68 (1st Cir. 1979) (discussing false accounts submitted by Chapter 11 debtor-in-possession). Therefore, Counts 3 and 4 should be dismissed. Petit correctly points out that Count 9 alleges the same conduct as that described in Counts 3 and 4 — the only difference being that in Count 9 the alleged violation is of 18 U.S.C. § 152(3). Subsection 3 concerns the making of a "false declaration, certificate, verification, or statement under penalty of perjury." Because bankruptcy schedules are submitted under penalty of perjury, this is the appropriate subsection under which the government may charge these defendants with filing falsified schedules and Count 9 should therefore not be dismissed.

Counts 5, 7 and 8 allege that Petit violated 18 U.S.C. § 152(2) in connection with testimony

given on May 17, 1994, December 4, 1995 and February 2, 1996. These counts are not subject to dismissal.[3] In its opposition to the dismissal motions, and in particular response to the suggestion that a bill of particulars is warranted as to these counts, the government identifies the allegedly false oaths and accounts at issue by directing the attention of the court and the defendants to particular paragraphs in the affidavit submitted in connection with the application for arrest that began this proceeding. According to that document, Petit appeared for a creditors' meeting pursuant to section 341 of the Bankruptcy Code on May 17, 1994 and testified that she had received no income since the filing of the bankruptcy petition. Affidavit of James Osterrieder ("Osterrieder Affidavit"), appended to Complaint (Docket No. 1) at ¶ 55. She was asked whether anyone had advanced funds to her to permit her to continue her lawsuit against Key Bank and she replied, "Oh yes and they are listed as creditors," referring to the schedules she had previously filed. *Id*. Assuming this testimony to have been false, it is plainly a false oath or account of the sort enjoined by section 152(2) and, thus, Count 5 is not subject to dismissal. So too with Count 7, which the government identifies as involving the conduct alleged in paragraph 115 of the Osterrieder Affidavit. According to that paragraph, Petit testified on December 4, 1995 at a second creditors' meeting pursuant to section 341 of the Bankruptcy Code, stating that she had not accepted any money since June 1993 in exchange for an interest in the Key Bank litigation and that she had solicited no funds on such a basis since that time. Osterrieder Aff. at ¶ 115. Asked if she had "sold any interest" in either the Key Bank suit or in possible attorney malpractice claims since October 30, 1990, she replied, "I have not sold any

[3] According to Petit, one reasons these four counts should be dismissed is that they allege the same conduct as that involved in Count 2. Even a cursory reading of the indictment reveals this is incorrect. Count 2 relates to the conduct enjoined by 18 U.S.C. § 152(1), i.e., the actual withholding of property belonging to the bankruptcy estate. Counts 4, 5, 7 and 8 concern the making of false statements — conduct implicated by 18 U.S.C. § 152(2).

interest in . . . that I know of." *Id*. She said she could not recall having made any agreements since October 30, 1990 to share the proceeds of such litigation with anyone. *Id*. And she testified that no one other than herself had the authority to enter into such agreements. *Id*. Count 7 is not subject to dismissal.

Count 8 relates to the conduct alleged in paragraph 119 of the Osterrieder Affidavit, which, in turn, describes a third creditors' meeting called pursuant to section 341. Petit testified that she had not transferred any interest in property — including intangible property such as "an interest in litigation" — since the commencement of the Chapter 11 proceedings. Osterrieder Aff. at ¶ 119. She further testified that her bankruptcy schedules accurately reflected her liabilities as filed and that there had been no change to her liabilities since their filing. *Id*. Again, assuming these statements to have been false, they plainly fall within the ambit of section 152(2).

Count 10 alleges the violation of 18 U.S.C. § 152(4) by Petit and Richard in connection with Richard's claim against the bankruptcy estate as listed in the schedules filed by Petit on February 25, 1994. Subsection 152(4) establishes that a person is guilty of bankruptcy fraud when he or she "knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney." According to Petit and Richard, this count must be dismissed because Richard never filed a proof of claim and the mere listing of a claim by the debtor cannot constitute bankruptcy fraud within the meaning of section 152(4). I disagree. As the government points out, the Bankruptcy Code explicitly provides that unless a claim is scheduled by the debtor as "disputed, contingent, or unliquidated," it is deemed to be filed under section 501 of the Code. 11 U.S.C. § 1111(a). The claim in question appears on the February 25, 1994 schedules as undisputed, non-contingent and

unliquidated. In other words, it was not necessary for Richard to have filed a proof of claim in order to pursue rights as a creditor of the estate. In their reply memorandum, Petit and Richard contend that to allow Count 9 to go forward in these circumstances would be to put debtors "on the razor's edge of prosecution" because the law also criminalizes the wilful omission of a creditor from the schedules. Petit and Richard's Consolidated Reply, etc. (Docket No. 138) at 15. A person is hardly on the razor's edge of prosecution when subjected to a statutory scheme that criminalizes both sins of omission and commission. Obviously, the objective is for the debtor to use the schedules to present an honest assessment of her debts. However, I do agree with Richard that this count of the indictment is appropriately dismissed as to him — for the simple reason that the conduct alleged involves the filing of bankruptcy schedules and it was Petit, as the debtor, who did the filing rather than him.

Count 11 alleges the violation of 18 U.S.C. § 152(5), which enjoins "knowingly and fraudulently receiv[ing] any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11." The indictment alleges that all five defendants violated this provision by knowingly and fraudulently receiving from Petit funds raised from the sale of assignments of proceeds from the Key Bank litigation. Similarly, Count 12 alleges the violation of 18 U.S.C. § 152(6), which makes a person guilty of bankruptcy fraud if he or she "knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act" in any case under the Bankruptcy Code. Again, the government's theory is that the defendants violated this provision as to the money raised by assigning proceeds from the civil litigation. The defendants' arguments for dismissing these counts are unpersuasive. As already noted, the fact that

assignments took place subsequent to the filing of the bankruptcy petition is not fatal to the government's case. Without citing authority, the defendants further contend that any of the conduct alleged in Counts 11 and 12 is not criminally sanctionable because it was done through the three corporations associated with Petit. The elements of bankruptcy fraud do not turn on whether the defendant is or even believes herself to be acting on behalf of a corporation or through a corporate entity. *See, e.g., United States v. Klupt*, 475 F.2d 1015 (2d Cir. 1973) (affirming bankruptcy fraud conviction of both individual defendant and corporation through which he acted).

Count 13 concerns 18 U.S.C. § 152(7), defining as bankruptcy fraud actions taken by a person who

> in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under [the Bankruptcy Code] by or against the person or any other person or corporation, or with intent to defeat the provisions of [the Bankruptcy Code], knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation.

The indictment alleges that the defendants violated this subsection by fraudulently transferring and concealing the civil litigation assignment funds. The defendants urge dismissal of this count on the theory that Petit's corporations, which were not in bankruptcy, were free to raise funds. This is not an appropriate basis for dismissal of Count 13. Even if acting through a corporation were a sufficient basis for evading criminal liability for bankruptcy fraud — a premise I have already considered and rejected, *supra* — this count, fairly read, goes beyond alleging actions taken by corporations and describes conduct taken by the defendants strictly in their individual capacities.

The defendants also seek dismissal of Counts 14 and 15. Count 14 concerns 18 U.S.C. § 152(8), making guilty of bankruptcy fraud a person who,

> after the filing of a case under [the Bankruptcy Code] or in contemplation thereof,

> knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor.

Count 15 alleges the violation of 18 U.S.C. § 152(9), which concerns a person who,

> after the filing of a case under [the Bankruptcy Code], knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor.

According to the indictment, the defendants violated these provisions as to records and recorded information reflecting the funds raised through the civil litigation assignments. The defendants' sole basis for dismissing these counts is that any of the records and recorded information at issue relates to post-petition transactions and is thus not among the information that can be withheld from the bankruptcy trustee only on risk of criminal sanction. For reasons already discussed, this position is devoid of merit. Beyond that, I would simply note that subsections 8 and 9 of the bankruptcy fraud statute do not limit themselves temporally to information relating to pre-petition transactions.

Finally, defendants Petit, David Hall, Morin and Richard complain that counts 2 through 15 essentially allege one act of bankruptcy fraud and, thus, that all but one count should be dismissed (Docket No. 90). Multiple counts "arising out of the same transaction" are multiplicitous in a manner that violates the Double Jeopardy Clause of the Fifth Amendment unless "each offense 'requires proof of an additional fact which the other does not.'" *United States v. Fraza*, 106 F.3d 1050, 1053 (1st Cir. 1997) (quoting *Blockburger v. United States*, 284 U.S. 299, 304 (1932)). A review of the various subsections of the bankruptcy fraud statute, quoted *supra*, and a review of the indictment make clear that each of the bankruptcy fraud counts either involves proof of facts that the others do not or (as to Counts 3 through 8, all of which implicate 18 U.S.C. § 152(2)) arises out of

a separate transaction.[4]

In sum, the only bankruptcy fraud counts subject to dismissal are 3 and 4 and, as to Richard only, Count 10. The motions to dismiss Counts 2-5 and 7-15 should otherwise be denied, as should the requests for a bill of particulars as to these counts. Particularly in light of its written opposition to the dismissal motions, the government has more than adequately described the conduct that forms the basis for these counts and, thus, the defendants are not hamstrung in their efforts to defend themselves against these charges or to plead a double jeopardy defense in the case of any future prosecution for criminal acts within the four corners of the indictment.[5]

The defendants separately contend (Docket Nos. 89, 105, 110, 112 and 114) that dismissal of the entire indictment is appropriate because it refers to the recently amended version of 18 U.S.C. § 152, which applies only to bankruptcies commenced after October 22, 1994 — well after the commencement of the Petit bankruptcy proceedings. In the alternative, the defendants seek dismissal of Counts 1, 2, 16-18, 19-88, 89-183 and 344 because these counts implicate section 152. Dismissal

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[4] Petit, David Hall, Morin and Richard make the same multiplicity argument as to the mail fraud counts (Nos. 16-88) and the money laundering counts (Nos. 89-322). A cursory review of the indictment reveals that each of these counts relates to separate transactions and thus no multiplicity issues are raised.

[5] Defendant Steven Hall moves separately for a bill of particulars on Counts 2, 11, 12, 13, 14 and 15 (Docket No. 101), which are the bankruptcy fraud counts in which he is charged. Steven Hall reasons that, because he was not the debtor-in-bankruptcy, his prosecution for bankruptcy fraud proceeds on an aiding-and-abetting theory, a contention the government does not dispute in its opposition to the pending motions. Therefore, according to Steven Hall, he is entitled to a bill of particulars because it is not possible for him to ascertain the sense in which the government believes he aided and abetted the bankruptcy fraud at issue. I disagree. There are references throughout the indictment, complaint and Osterrieder Affidavit to Steven Hall's extensive role in selling assignments of the Key Bank litigation. Significantly, this defendant also stands accused of participating in a meeting in late 1994 or early 1995 designed to "enabl[e] all of the people raising funds for PETIT to 'get their story straight' if PETIT's bankruptcy trustee, Peter Fessenden, contacted them or asked them any questions." Osterrieder Aff. at 72.

of any counts on such a basis would be inappropriate.

In relevant part, the 1994 amendment to section 152, part of the Bankruptcy Reform Act of 1994, added a specific reference to the United States Trustee. P.L. 103-394 at § 312, 108 Stat. 4106, 4138 (1994). The office of the United States Trustee was, in turn, permanently created in 1986 as a means of separating certain administrative functions of bankruptcy proceedings from adjudicative ones, all of which had previously been handled directly by the bankruptcy courts. *See* 11 U.S.C. § 307 (as added by P.L. 99-554, 100 Stat. 3088); H.R. Rep. No. 99-764, at 17-22, *reprinted in* 1986 U.S.C.C.A.N. 5227, 5229-34. The House Report accompanying the 1994 Bankruptcy Reform Act does not describe the explicit reference to U.S. Trustees as a substantive change in the statute, but rather points to the requirement of "specific intent to defraud" as an "essential element of the new fraud action." H.R. Rep. No. 103-835, at 57-58, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366-67. The only plausible inference is that the addition of the reference to the U.S. Trustee was in the manner of a clarification rather than a substantive amendment and, thus, that defrauding the U.S. Trustee was a violation of section 152 prior to the 1994 enactment. Therefore, to the extent the indictment refers to the wrong version of section 152, there is no prejudice to the defendant sufficient to warrant dismissal. *See* Fed.R.Crim.P. 7(c); *United States v. Isabel*, 945 F.2d 1193, 1196-98 (1st Cir. 1991).

II. Mail fraud

Counts 16 through 88 allege mail fraud in violation of 18 U.S.C. § 1341. Defendants David Hall, Steven Hall, Morin and Richard seek dismissal of Counts 17, 18, 26, 36, 40, 48, 52, 62, 74, 75, 83 and 87 (Docket Nos. 100, 110, 112 and 114); According to these defendants, Count 17 should

be dismissed because it alleges a delivery via Federal Express on August 8, 1994 — approximately a month before Congress amended the mail fraud statute to include items consigned to carriers other than the U.S. Postal Service. *See* P.L. 103-322, 108 Stat. 1796, § 250006(1) (adding reference to "any private or commercial interstate carrier," effective Sept. 13, 1994). The defendants' motion concerning allegedly improper grand jury practice (Docket Nos. 89, 105, 110, 112 and 114), discussed *supra* in connection with the bankruptcy fraud counts, makes in essence the same argument as to Counts 16-18. The government concedes that dismissal of Count 17 is appropriate for this reason, and I therefore so recommend.

As to the other referenced mail fraud counts, the defendants complain that the indictment alleges only delivery by an unknown carrier. The government urges the court not to dismiss these counts on such a basis because it is prepared to prove at trial that the requisite mailing took place.[6] Because these counts of the indictment sufficiently charge the offense of mail fraud, I recommend that the court deny the motion to dismiss on the assumption that the government could indeed prove its case as to the elements stated therein. *See, e.g., United States v. Sampson,* 371 U.S. 75, 78-79 (1962) (prior to trial, "the indictment must be tested by its sufficiency to charge an offense").

III. Securities Fraud

Finally, the defendants urge the court to dismiss Counts 323-343, all of which allege securities fraud in violation of the applicable provisions of the Securities Act of 1933, 15 U.S.C. § 77q, in connection with the sale of assignments of interests in the Key Bank litigation. They

[6] As with Count 17, the offense charged in Count 18 antedates the amendment of the mail fraud statute to include items delivered by private carriers, and I thus understand the government's position to be that it is prepared to show that the mailing alleged in Count 18 involved the U.S. Postal Service.

contend that whatever was alleged to have been sold were not securities within the meaning of the statute (Docket Nos. 34, 88, 104, 110, 112). I disagree.

The applicable definition of a security is that contained in the 1933 Act and includes, *inter alia*, any "note" or "investment contract." 15 U.S.C. § 77b(a)(1). The government's position is that the assignments at issue meet either cited aspect of the definition.

One initial point requires clarification. Both the 1933 Act and the Securities and Exchange Act of 1934 include similar definitions of the word "security." *Compare id. with* 15 U.S.C. § 78c(a)(10). However, the definition in the 1934 Act contains a limitation that the 1933 statute does not: a clarification that the term "security" does not include any note "which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." 15 U.S.C. § 78c(a)(10). Under the 1933 Act, notes of such short duration arising out of a "current transaction" are deemed "[e]xempted securities," 15 U.S.C. § 77c(a) and (a)(3), but the fraud provisions of the 1933 Act under which the defendants are charged explicitly provide that the exemptions enumerated in section 77c are inapplicable to it, see 15 U.S.C. § 77q(c). Therefore, Petit, David Hall, Steven Hall and Richard are incorrect in their contention that the short-term duration of the instruments at issue precludes any prosecution under section 77q.

The Supreme Court has had occasion to discuss at length the question of when an instrument is a "note" within the meaning of the 1943 Act in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), stressing that for purposes of the discussion included therein the analysis is equally applicable to the 1993 Act, *see id.* at 61 n.1.

First, we examine the transaction to assess the motivations that would prompt a

> reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security." Second, we examine the plan of distribution of the instrument to determine whether it is an instrument in which there is common trading for speculation or investment. Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not "securities" as used in that transaction. Finally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.

Id. at 66-67 (citations and internal quotation marks omitted). In applying this test, the court must keep in mind that because the Securities Acts by their terms cover "any note," there is a "presumption that every note is a security" that can only be overcome only through application of the enumerated standards.[7] *Id*. at 65.

Pursuant to this test, among the kinds of notes that are not considered securities are "the short-term note secured by a lien on a small business or some of its assets." *Id*. (citation omitted). In their reply memorandum, Petit and Richard suggest that the instruments at issue here bear a strong resemblance to this kind of investment. In support of such a contention, they point out that all of the

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[7] In so holding, the Supreme Court was careful to express no view on whether such a presumption would apply to notes subject to the less-than-nine-months exception. *Id*. at 65 n.3. Since, as already discussed, that exception is inapplicable here, it cannot defeat the presumption even though the instruments at issue were of less than nine months' duration.

In articulating its standard for what is a security under the Securities Acts, the Court was endorsing the so-called "family resemblance" test first established by the Second Circuit, which had identified certain kinds of notes that did bear the requisite resemblance to the kind of transactions Congress intended to regulate. *Id*. at 65 (citation omitted). The Court made clear that the Second Circuit's list is "not graven in stone" but subject to addition as appropriate. *Id.* at 66-67 (citation omitted).

notes were to be repaid within nine months and each was secured by an interest in what was the only asset of Petit's small businesses, which she was seeking to further through the capital-raising efforts at issue.

In my view, the court is not in a position to determine at this stage of the proceeding that the transactions at issue were not securities under the test laid down by the Supreme Court in *Reves*. The affidavit describes a scenario in which owners of annuities, and others, were induced to invest in the litigation on the promise of a higher investment return and a guaranteed return of principal. *See*, *e.g.*, Osterrieder Aff. at ¶¶ 59-64, 76-80, 94-110. According to the government, the transactions at issue in counts 323 through 341 involved the outright assignment of proceeds from the Key Bank litigation, whereas the remaining securities fraud counts concern investment shares sold in HER, Inc., which was represented to investors as a real estate concern but was, in fact, a vehicle to raise money for Petit. According to the Osterrieder Affidavit, at least some of the assignments were purchased by investors who had "cashed out" annuities and were induced to invest in the assignments on the promise of receiving a better return than the annuities provided. *See* Osterrieder Aff. at ¶¶ 59-64. Defendant Steven Hall allegedly told one such client he solicited that converting his annuity funds to an investment in the litigation-proceeds assignments was a "no risk" proposition. *Id*. at 94(a). Assuming that the facts proven at trial are consistent with the foregoing, I cannot rule out the possibility that the appropriate determination is that the notes in question are securities within the meaning of the Securities Acts and, thus, the statute criminalizing securities fraud.[8]

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[8] One issue that may require resolution, and about which I express no opinion, is whether it is for the court or the jury ultimately to decide whether any notes were securities within the meaning of *Reves*. *See Ahrens v. American-Canadian Beaver Co.*, 428 F.2d 926, 928 (10th Cir. 1970) (deeming issue in civil context to be one of law); *but see Ahern v. Gaussoin*, 611 F.Supp. (continued...)

One assumption that is implicit in the foregoing analysis is that the transactions at issue were each memorialized with a written note. According to Morin, David Hall and Richard, this is not so and, in fact, only a few of the assignments involved actual written instruments. Even assuming that some of the transactions did not involve notes, dismissal of any of the securities fraud counts is still inappropriate because the court cannot rule out the possibility that the transactions were investment contracts within the meaning of 15 U.S.C. § 77b(a)(1).

This court has previously noted that

> [t]he classic definition of an investment contract was set forth long ago by the Supreme Court in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). It includes "any contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third person." *Id*. at 298-99, 66 S.Ct. at 1102-03.

Lavery v. Kearns, 792 F.Supp. 847, 851 (D.Me. 1992). The defendants here vigorously assert that the requisite common enterprise is lacking. I disagree.

> A common enterprise is proven by demonstrating that there was horizontal or vertical commonality. Horizontal commonality is defined as the pooling of assets from two or more investors into a single investment fund, usually combined with a pro rata share of the profits. Vertical commonality is established when the investment manager's fortunes rise and fall with those of the investor. The First Circuit has not yet determined which type of commonality need be present to prove the existence of a common enterprise.

S.E.C. v. Deyon, 977 F.Supp. 510, 516 (D.Me. 1997) (citations and internal quotation marks omitted).[9] The court's task in determining whether the transactions at issue were investment

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[8](...continued)
1465, 1477 (D.Or. 1985) (same, but noting that underlying factual disputes should be submitted to jury).

[9] As noted in *Lavery*, by "[v]ertical commonality" the court is referring to "narrow" as distinct from "broad" vertical commonality, the former being a situation in which "the investment (continued...)

contracts is "to look at the economic reality of the situation presented, rather than taking a formalistic approach to the facts." *Lavery*, 847 F.Supp. at 851 (citing *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975)).

Again accepting the government's version of the facts to be the correct one for purposes of analysis, the requirement of horizontal commonality is easily satisfied. The defendants stand accused of amassing funds from a wide variety of investors, ostensibly for the purpose of pursuing the Key Bank litigation, with the investors' return varying according to the success of the litigation in proportion to each investor's financial contribution. On the issue of vertical commonality, the government makes much of certain alleged aspects of the fundraising at issue that would cause it to resemble a classic pyramid scheme, i.e., the paying off of prior investments through capital infusions from subsequent investors (as opposed to gains reaped through the success of the actual enterprise ostensibly capitalized by the investors). In my view, however, the court need not unravel those aspects of the allegations but may find vertical commonality in the simple underlying reality that, ultimately, the fortunes of both the defendants and their investors were intended to vary with the success of the Key Bank litigation.

In sum, whether the assignments at issue are viewed as notes or investment contracts, the defendants are not entitled to dismissal of the securities fraud counts on the theory that the government cannot prove the investments were securities within the meaning of the Securities Act

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[9](...continued)
manager's fortunes rise and fall with those of the investor" and the latter involving "merely a link between the investor's fortunes and the promoter's efforts." *Lavery*, 792 F.Supp. at 851-52.

of 1933. Any issues raised by the defendants in that regard must await trial.[10]

IV. Conclusion

For the foregoing reasons, I recommend that the motions to dismiss filed by the defendants implicating, *inter alia,* Counts 3, 4 and 17 of the indictment (Docket Nos. 87, 89, 103, 105, 110, 112 and 114) be **GRANTED** as to Counts 3, 4 and 17, and that all of the pending motions to dismiss the indictment or for a bill of particulars (Docket Nos. 34, 87, 88, 89, 90, 100, 101, 103, 104, 105, 110, 112, 114, 124 and 128) otherwise be **DENIED**.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated this 11th day of June, 1998.

David M. Cohen
United States Magistrate Judge

[10] Richard separately seeks dismissal of Count 338 (Docket No. 124) on the ground that this count does not specifically allege the manner in which the check in question was transmitted or its destination. This count is not subject to dismissal at this stage on such a basis for the same reason the mail fraud counts are not subject to dismissal.